Report

of the

Examination of

Arlington Mutual Fire Insurance Company

Arlington, Wisconsin

As of December 31, 2004

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 27, 2005

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2004, of the affairs and financial condition of:

ARLINGTON MUTUAL FIRE INSURANCE COMPANY
Arlington, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Arlington Mutual Fire Insurance Company (the company) was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2004, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was organized as a town mutual insurance company on June 21, 1873, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Arlington Farmers Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was one amendment to the articles of incorporation and no amendments to the bylaws. The amendment, which allows the company to write business in the counties of Green Lake, Iowa and Marquette, was adopted with the required quorum at the annual meeting held on February 29, 2000, and it was approved by the Commissioner.

The company is currently licensed to write property, including windstorm and hail and nonproperty insurance. The company is currently licensed to write business in the following counties:

Columbia	Green Lake
Dane	Iowa
Dodge	Marquette
Sauk	

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of three years with premiums payable on the advance premium basis.

Business of the company is acquired through 19 agents, three of whom are directors and one who is an employee. Agents are presently compensated for their services at a 15% rate of commission for all new and renewal business. In addition, agents can receive a contingent commission on property insurance equal to 2% of premiums written if the losses incurred on such property insurance total 15% or less of the premiums written or equal to 1% of premiums written if the loss ratio is more than 15% but less than 20%. The potential for contingent commission applies only to property insurance and not to any portion of nonproperty insurance. Contingent commission is due and payable on the first day of August of the following calendar year.

Agents have authority to adjust losses up to $2,000; however, the adjusting committee adjusts and reviews all losses, including those adjusted by agents. Adjusters receive $35 for each loss adjusted plus $0.375 per mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Harold Patton	Retired	Dane, Wisconsin	2005
Robert Stiemke	Retired	Arlington, Wisconsin	2005
Thomas Manke	Farmer	Arlington, Wisconsin	2005
Dennis Kelley	Farmer	Arlington, Wisconsin	2006
William Steffenhagen	Retired	Arlington, Wisconsin	2006
Jane Jensen *	Secretary/Treasurer/Manager	Arlington, Wisconsin	2006
James Attoe *	Farmer	Poynette, Wisconsin	2007
Jerome Breunig	Retired	Waunakee, Wisconsin	2007
Marvin Jameson *	Insurance Agent	Rio, Wisconsin	2007

* Directors who are also agents are identified with an asterisk.

Members of the board currently receive $100 for each meeting attended and $0.375 per mile for travel expenses.

The company is in compliance with the requirements of s. Ins 612.13 (1m), Wis. Stat., with respect to limitations on the number of inside directors.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2004 Salary
William Steffenhagen	President	$ 8,000
Marvin Jameson	Vice President	23,177*
Jane Jensen	Secretary/Treasurer/Manager	89,309**

* Commission, adjusting expenses and meeting fees.
** Includes $32,988 of commission.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The only committee at the time of the examination is listed below:

Adjusting Committee
Jane Jensen, Chair
William Steffenhagen
James Attoe
Marvin Jameson

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2004	$975,540	2,606	$ (4,850)	$4,331,349	$3,208,347
2003	873,034	2,526	207,161	4,108,409	3,115,102
2002	742,474	2,386	40,668	3,938,823	2,926,909
2001	695,188	2,229	(224,361)	3,870,018	2,940,335
2000	691,769	2,185	158,585	3,830,620	3,176,344
1999	823,139	2,192	146,584	3,648,634	2,969,012
1998	813,336	2,260	(7,869)	3,422,285	2,827,112

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Writings Ratios Net
2004	$1,597,163	$1,008,562	$3,208,347	50%	31%
2003	1,473,472	953,290	3,115,102	47	31
2002	1,326,118	800,173	2,926,909	45	27
2001	1,203,668	725,793	2,940,335	41	25
2000	1,150,081	698,954	3,176,344	36	22
1999	1,105,928	822,516	2,969,012	37	28
1998	1,092,425	812,059	2,827,112	39	29

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
2004	$683,901	$379,592	$975,540	70%	38%	108%
2003	379,024	377,416	873,034	43	40	83
2002	476,936	324,540	742,474	64	41	105
2001	740,762	306,375	695,188	107	42	149
2000	356,435	286,847	691,769	52	41	93
1999	507,063	276,484	823,139	62	34	95
1998	685,421	267,073	813,336	84	33	117

Over the past six years, surplus increased 8% to $3,208,347 and admitted assets 19% to $4,331,349. Net premium written increased 23% since 1999 due to a combination of 19% of increase in the policies in force, as the company expanded the territory in which it writes business, and to a lesser extent a rate increase effective in 2003. In all years under examination the company has maintained an underwriting expense ratio below the industry average for all Wisconsin town mutuals. The company has had a net loss and loss adjustment expense ratio over the industry average in 2004, 2002 and 2001; calendar years in which the company reported an underwriting loss. The company experienced net losses of $4,850 and $224,361 in 2004 and 2001, respectively. The Wisconsin town mutual industry as a whole experienced a net loss in 2001 and underwriting losses in 2001 and 2002. In 2004, the company had adverse underwriting results due to a severe wind and hail storm which caused slightly less than 30% of the total property losses paid in that year.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2005
Termination provisions:	Either party may terminate the contract as of January 1, 2006, or any subsequent January 1, by giving to the other party at least 90 days advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Excess of Loss Reinsurance
	Lines reinsured:	All liability (nonproperty) business
	Company's retention:	$5,000 for each and every loss occurrence. The reinsurer may permit the company to adjust property damage losses that fall within the company's net loss retention.
	Coverage:	Loss and loss adjustment expense in excess of the company's retention up to the following maximum policy limits: $1,000,000 – per occurrence, single limit, combined for bodily injury and property damage liability. $1,000,000 – split limits, in any combination of bodily injury and property damage liability. $5,000 – for medical payments, per person; $25,000 per accident.
	Reinsurance premium:	55% for each and every policy of the business covered.
2.	Type of contract:	Class B First Surplus Reinsurance
	Lines reinsured:	Property
	Company's retention:	When the company's net retention is $1,000,000 or more, the company may cede on a pro rata basis up to $800,000. When the net retention is $1,000,000 or less, the company may cede up to 50% of such risk.
	Coverage:	Pro rata share of each and every loss, including loss adjustment expense, corresponding to the amount of the risk ceded.

	Reinsurance premium:	Pro rata of all premiums, fees and assessments corresponding to each of the risk ceded.
	Ceding commission:	Commission allowance: 15% of the premium paid Profit commission: 15% of the net profit
3.	Type of contract:	Class C-1 First Layer Excess of Loss Reinsurance
	Lines reinsured:	Property
	Company's retention:	$50,000 for each and every loss occurrence.
	Coverage:	100% of any loss, including loss adjustment expenses, in excess of $50,000 up to a maximum of $50,000 per risk.
	Reinsurance premium:	The rate in effect shall be determined by taking the sum of the four years' losses incurred (paid plus outstanding) by the reinsurer divided by the total of the net premiums written for the same period, multiplied by the factor 100/80ths, subject to a maximum rate of 19% and a minimum rate of 6%. The current effective rate is 6%. The current deposit premium is $104,280, subject to a minimum premium of $80,000.
4.	Type of contract:	Class C-2 Second Layer Excess of Loss Reinsurance
	Lines reinsured:	Property
	Company's retention:	$100,000 for each and every loss occurrence up to $400,000.
	Coverage:	100% of any loss, including loss adjustment expenses, in excess of $100,000 for each and every risk up to a maximum of $400,000 per risk.
	Reinsurance premium:	4% of the current net premiums written Deposit premium: $69,250 Minimum premium: $55,000
5.	Type of contract:	Class C-3 Third Layer Excess of Loss Reinsurance
	Lines reinsured:	Property
	Company's retention:	$500,000 for each and every loss occurrence up to $500,000.
	Coverage:	100% of any loss, including loss adjustment expenses, in excess of $500,000 for each and every risk up to a maximum of $500,000 per risk.
	Reinsurance premium:	2% of the current net premiums written Deposit premium: $34,760 Minimum premium: $23,000

6. Type of contract: Class D/E-1 First Aggregate Stop Loss Reinsurance

Lines reinsured:	Property and nonproperty
Company's retention:	Annual aggregate losses, including loss adjustment expenses, up to 70% of the company's net premium written; subject to a minimum retention of $800,000.
Coverage:	100% of annual aggregate losses, including loss adjustment expenses, exceeding 70% of net premium written and in excess of the company's retention.
Reinsurance premium:	The rate in effect shall be determined by taking the sum of the eight years' losses incurred by the reinsurer divided by the total of the net premiums written for the same period multiplied by the factor of 100/80ths, subject to a maximum rate of 25% and a minimum rate of 6.5%. Current rate: 15.44% Deposit premium: $292,665 Minimum premium: $200,000.

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2004, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Arlington Mutual Fire Insurance Company
Statement of Assets and Liabilities
As of December 31, 2004

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash deposited in checking account	$ 202,870	$	$	$ 202,870
Cash deposited at interest	2,156,158			2,156,158
Bonds	778,636			778,636
Stocks and mutual fund investments	947,686			947,686
Real estate	42,629			42,629
Premiums, agents' balances and installments:				
Deferred and not yet due	147,493			147,493
Investment income accrued		34,578		34,578
Reinsurance recoverable on paid losses and LAE	18,192			18,192
Electronic data processing equipment	670			670
Other expense related assets:				
Reinsurance commission receivable	2,437			2,437
Furniture and fixtures	4,179		4,179	0
Totals	$4,300,950	$34,578	$4,179	$4,331,349

Liabilities and Surplus

Net unpaid losses	$ 327,728
Unpaid loss adjustment expenses	13,962
Commissions payable	30,886
Fire department dues payable	661
Unearned premiums	727,832
Reinsurance payable	12,680
Amounts withheld for the account of others	3,593
Payroll taxes payable (employer's portion)	868
Other liabilities:	
Expense related:	
Accounts payable	1,687
Accrued property tax	3,105
Total Liabilities	1,123,002
Policyholders' surplus	3,208,347
Total Liabilities and Surplus	$4,331,349

Arlington Mutual Fire Insurance Company
Statement of Operations
For the Year 2004

Net premiums and assessments earned		$ 975,540
Deduct:		
Net losses incurred	$636,781	
Net loss adjustment expenses incurred	47,120	
Other underwriting expenses incurred	379,592	
Total losses and expenses incurred		1,063,493
Net underwriting gain (loss)		(87,953)
Net investment income:		
Net investment income earned	82,756	
Net realized capital gains	200	
Total investment gain (loss)		82,956
Miscellaneous Income		138
Net income (loss) before federal income taxes		(4,859)
Federal income taxes incurred		(9)
Net Income (Loss)		$ (4,850)

Reconciliation and Analysis of Surplus as Regards Policyholders
For the Six-Year Period Ending December 31, 2004

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2004	2003	2002	2001	2000	1999
Surplus, beginning of year	$3,115,102	$2,926,909	$2,940,335	$3,176,344	$2,969,012	$2,827,112
Net income	(4,850)	207,161	40,668	(224,361)	158,585	146,584
Net unrealized capital gains or (losses)	96,889	(18,765)	(54,722)	(14,102)	46,294	(3,627)
Change in nonadmitted assets	1,206	(203)	628	2,454	2,453	(1,057)
Surplus, end of year	$3,208,347	$3,115,102	$2,926,909	$2,940,335	$3,176,344	$2,969,012

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2004, is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Reinsurance—It is suggested that the company annually review the risks associated with not utilizing its Class B layer of reinsurance.

   Action—Compliance.

2. Reinsurance—It is recommended that the company properly disclose its net exposure to its largest risk in the General Interrogatories of future annual statements.

   Action—Partial Compliance. See comments in the summary of current examination results.

3. Underwriting—It is recommended that the company establish a formal inspection procedure for new and renewal business, whereby committee members independent of the risk under consideration inspect new applications and a sampling of renewal business.

   Action—Partial Compliance. See comments in the summary of current examination results.

4. Accounts and records—It is recommended that the company establish and maintain an actual general ledger and journal as required by s. Ins 13.05, Wis. Adm. Code.

   Action—Compliance.

5. Cash and Invested Cash—It is recommended that the company report in a timely manner escheatable checks in accordance with ss. 177.17 and 177.19, Wis. Stat.

   Action—Compliance.

6. Premiums, Agent's Balances, and Installments Booked But Deferred and Not Yet Due—It is again recommended that the company establish a liability for the estimated amount of premium that may be returned to its agents due to policyholder nonpayment.

   Action—Compliance. See comments in the summary of current examination results.

7. Premiums, Agent's Balances, and Installments Booked But Deferred and Not Yet Due—It is recommended that the company maintain copies of agent billings.

   Action—Compliance.

8. Net Unpaid Losses—It is again recommended that outstanding claims be reviewed and settled in a timely manner as prescribed in s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

   Action—Noncompliance. See comments in the summary of current examination results.

9. Net Unpaid Losses—It is again recommended that agents of the company provide information on all claim activity reported, adjusted, and settled on a weekly basis.

   Action—Noncompliance. See comments in the summary of current examination results.

10. Net Unpaid Losses—It is again recommended that the company maintain a proper loss register as prescribed in s. Ins 13.05 (3) (f), Wis. Adm. Code.

    Action—Noncompliance. See comments in the summary of current examination results.

11. Net Unpaid Losses—It is again recommended that the company maintain a file for each individual loss reported, which includes the claim number that matches the company's current loss register, insured's name, policy number, nature of loss, loss date, coverage under policy, estimated amount of loss, date reported, status of claim and payment information as required by s. Ins 13.05 (4) (e), Wis. Adm. Code.

    Action—Compliance.

12. Unearned Premiums—It is recommended that the company not cancel policies until after coverage has been terminated.

    Action—Compliance.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Reinsurance

During the prior examination it was recommended that the company properly disclose its net exposure to its largest risk as the company reduced the exposure of its largest risk with Class B reinsurance when in fact there was no Class B purchased from the reinsurer. The company has partially complied with the prior exam recommendation as it has since purchased Class B reinsurance; however, the amounts reported in the annual statement for the insured risk and the reinsurance balances are not correct. It is again recommended that the company properly disclose its net exposure to its largest risk in the General Interrogatories of future annual statements.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Employee Surety Bond	
Each officer	$ 250,000
Forgery or alteration	250,000
Securities	250,000
Trading Loss	250,000
Worker's Compensation	Statutory
Employer's liability	
Bodily injury by accident	100,000 each accident
Bodily injury by disease	100,000 each employee
Bodily injury by disease	500,000 policy limit
Errors & Omissions	2,000,000 per claim
on agents	5,000 deductible
Professional liability directors and officers	
Company professional liability	3,000,000 per claim and aggregate
Directors and officers	3,000,000 per claim and aggregate
Deductible	5,000 professional liability, directors and officers
Commercial Liability	
General aggregate limit	1,000,000
Products aggregate limit	1,000,000
Personal and advertising limit	1,000,000
Each occurrence limit	1,000,000
Damage to premises	100,000
Medical limit per person	5,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The prior examination recommended that the company establish a formal inspection procedure; and on December 17, 2002, the board of directors approved a brief inspection questionnaire to be utilized during the inspections. A sample of the policy files showed that the company was not utilizing the inspection questionnaire. In addition, this questionnaire appears insufficient to document conditions of the insured risks. It is again recommended that the company establish and follow a formal inspection procedure for new and renewal business, and it is suggested that the photographs of insured risks be included as part of the procedure.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2004.

Examiners noted that the company’s manager has access to the mail, cash receipts and disbursements, and that she performs the accounting and reconciliation of the bank account. It is a sound accounting control procedure to segregate the duties of signing checks and handling cash from those performing accounting functions and reconciling month-end bank balances. Furthermore, the company has adequate staffing to better segregate the cash handling function. It is recommended that the company properly segregate the duties of signing checks and handling cash from those of performing the accounting functions and reconciling month-end bank balances in accordance with s. Ins 13.05 (4) Wis. Adm. Code.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computer is limited to people authorized to use the computers. Company personnel back up the computers daily and the backed-up data is kept off-site.

The company does not have manuals documenting the use of its software but assistance from the software vendor is available by phone.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan which addresses where the data is saved and how it can be recovered. During the examination it was suggested that the business continuity plan identifies procedures to be performed in the event that there is no access to its computers, a key employee is lost or the office building is destroyed.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$1,423,002
2.	Liabilities plus 33% of gross premiums written	1,650,066
3.	Liabilities plus 50% of net premiums written	1,627,283
4.	Amount required (greater of 1, 2, or 3)	1,650,066
5.	Amount of Type 1 investments as of 12/31/2004	3,078,151
6.	Excess or (deficiency)	$1,428,085

The company has sufficient Type 1 investments.

ASSETS

Cash and Invested Cash **$2,359,028**

The above asset is comprised of the following types of cash items:

Cash deposited in banks-checking accounts	$ 202,870
Cash deposited in banks at interest	2,156,158
Total	$2,359,028

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of checking account balance was made by obtaining confirmation from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of 48 deposits in 29 depositories. Deposits were verified by correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2004 totaled $62,832 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1.49% to 5.39%. Accrued interest on cash deposits totaled $25,133 at year-end.

Book Value of Bonds **$778,636**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2004. Bonds owned by the company are located in the company’s safety deposit box as well as with one bank investment custodian.

Bonds held at the company’s safety deposit box were physically inspected by the examiners. Bonds held with the investment custodian were confirmed to year-end custodian statement detail. Bond purchases for the period under examination were checked to broker and custodian statements. The company’s investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2004 on bonds amounted to $33,761 and was traced, on a sample basis, to the custodian statement. Accrued interest of $9,064 at December 31, 2004, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$947,686**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2004. Stocks owned by the company are located in the company's safety deposit box, and mutual funds with the company's investment custodian.

Stock certificates held in the company's safety deposit box were physically examined by the examiners. Stocks held with the investment custodian were confirmed to year-end custodian detail. No exceptions were noted. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2004 on stocks and mutual funds amounted to $33,411 and were traced to cash receipts records. Accrued dividends of $381 at December 31, 2004, were checked and allowed as a nonledger asset.

Book Value of Real Estate **$42,629**

The above amount represents the company's investment in real estate as of December 31, 2004. The company's real estate holdings consisted of the home office in Arlington, Wisconsin.

The required documents supporting the validity of this asset were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Premiums Deferred and Not Yet Due **$147,493**

This asset represents premiums which are receivable from policyholders but which are not yet due as the policyholder has chosen a semiannual billing mode. A review of a sample from the company's detailed list of deferred premiums verified the accuracy of this asset.

The company's agents are responsible for the collection of all premiums. Per agreement, agents are required to have a trust account for the deposit of premiums until the payment is submitted to the company, net of commission. Agents are required to give the company full payment on all policies written within 25 days from the end of the month in which the premiums are due; even if an insured has not paid the agent. The company will later reimburse the agent in the event that an insured is ultimately cancelled for nonpayment. Agent's balances are settled on July and December of each year.

The prior examination report indicated that the company should establish a liability for the estimated amount of premium which will be returned to its agents due to policyholder nonpayment, or reduce its agent's balances through the nonadmission of amounts due to its agents which are in excess of 90 days past due. During the current examination the company provided documentation to examiners which showed that the amount of premiums returned to agents due to policyholder nonpayment was immaterial. The examination concluded that there is no need to establish a liability as the likelihood of this contingency is remote and immaterial; however, it should be noted that if at any time the balance becomes material, the company should establish a liability.

Investment Income Accrued **$34,578**

Investment income due and accrued on the various assets of the company at December 31, 2004, consists of the following:

Cash at interest	$25,133
Bonds	9,064
Stocks	381
Total	$34,578

Investment Income Accrued was recalculated and balance appeared reasonable.

Reinsurance Recoverable on Paid Losses and LAE **$18,192**

The above asset represents recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2004. A review of year-end and subsequent accountings with the reinsurer indicated that the balance is reasonable; however, examiners noted that some of the recoveries reported to the reinsurer were not correct nor timely filed. The company reported recoveries at year-end for losses that did not have reinsurance coverage at the date of loss, one recovery was not net of the policyholder's deductible, one recovery was reported for the insured amount instead of the amount of the damage determined by the adjuster, and one recovery balance at year-end was not filed to the reinsurer. No adjustment to surplus was performed as the misstatement was under tolerable error. It is recommended that the company establish proper controls to ensure that the loss bordereau reports are filed correctly and timely with the reinsurer.

Electronic Data Processing Equipment **$670**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2004. A review of receipts and other documentation verified the balance. Nonoperating system software was properly nonadmitted on the annual statement.

Reinsurance Commission Receivable **$2,437**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2004, based on the profitability of the business ceded under its contract with reinsurer. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer indicated that the balance was reasonable.

Furniture and Fixtures **$0**

This asset consists of $4,179 of furniture and fixtures owned by the company at December 31, 2004. In accordance with annual statement requirements, this amount has been reported as nonadmitted asset, thus the balance shown above is $0.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$327,728**

This liability represents losses incurred on or prior to December 31, 2004, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2004, with incurred dates in 2004 and prior years. To the actual paid loss figure was added an estimated amount for 2004 and prior losses remaining unpaid at the time of the examination. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$755,330	$927,427	$(172,097)
Less: Reinsurance recoverable on unpaid losses	427,602	680,579	(252,977)
Net Unpaid Losses	$327,728	$246,847	$ 80,881

The above difference of $80,881 was considered material for purposes of this examination; however, no adjustment (increase) to surplus was performed as the company's controls over losses appear not to be adequate. Examiners noted that at year-end the company had reserves for claims that were already closed prior to December 31, 2004, and that the agents' detail of open claims was not complete. Subsequent payments revealed that there were claims reported in 2004 which were not included in the agents' list at year-end. In addition, it was noted that some claims did not have a claim number assigned in compliance with s. Ins 13.05 (4) (e), Wis. Adm. Code, as these claims were not promptly reported to the company.

The examiners' review of claim files included open claims, paid claims, and claims closed without payment. The review indicated that claims are investigated and evaluated properly in accordance with policy provisions upon the submission of a proper proof of loss, except as noted below. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is NOT maintained. The loss register is in compliance with legal requirements as prescribed in s. Ins 13.05 (3) (f), Wis. Adm. Code; however, the balances as of year-end and as of the date of fieldwork do not always support the information and balances contained in the claim files and in the agent's reports.

It is recommended that the company maintain a loss register which supports its transactions and account balances and that the information of the claim files be periodically reconciled with the loss register.

2. Claim files contained reasonable investigatory data and documentation to verify settlement payments or reserve estimates; however, some discrepancies were found with the information provided in the loss register.

3. Proofs of loss were properly signed.

In the past two prior examinations it was noted that the company's agents, who are responsible for reporting insured claims, were inconsistent in reporting loss notifications to the company and that outstanding claims were not reviewed and settled in a timely manner.

The company continues to allow claims to remain open for a number of years without settlement, while it waits for information from the claimant or for the insured to repair covered damages. This practice may be interpreted to be an unfair settlement policy by its failure to initiate and conclude claim investigations in a reasonable period of time. It also increases the company's exposure to additional loss sustained on damaged and unrepaired property. It is recommended for the third time that the company adopt procedures for timely settlement of claims in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

Agents continue to report claims to the company inconsistently and not timely; therefore, it is recommended for the third time that the agents of the company provide information on all claim activity reported, adjusted and settled on a weekly basis. In addition, it is suggested that the company develop a form containing all the information required by s. Ins 13.05 (3) (f), Wis. Adm. Code, so that agents report claims in a uniform and timely manner to the company. This information then should be periodically reconciled with the loss register.

Unpaid Loss Adjustment Expenses $13,962

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2004, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is based on 5% of the total gross property liability unpaid.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be reasonably stated.

Commissions Payable **$30,886**

This liability represents the commissions payable to agents as of December 31, 2004. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated; however, the totals for premiums and losses per the agents' reports for the calculation of contingent commissions did not agree with the annual statement amounts. It is recommended that the premium and loss information utilized to calculate the contingent commissions due to agents agree with the property premium and loss information reported on the annual statement.

Fire Department Dues Payable **$661**

This liability represents the fire department dues payable to the State of Wisconsin as of December 31, 2004.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$727,832**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$12,680**

This liability consists of amounts due to the company's reinsurer at December 31, 2004, relating to transactions which occurred on or prior to that date. Subsequent cash disbursements and reinsurance accounting verified the amount of this liability.

Amounts Withheld for the Account of Others **$3,593**

This liability represents employee payroll deductions in the possession of the company at December 31, 2004. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable **$868**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2004, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$1,687**

This liability represents miscellaneous company liabilities that were incurred prior to December 31, 2004, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accrued Property Taxes **$3,105**

This liability represents the company’s portion of property taxes incurred prior to December 31, 2004, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

V. CONCLUSION

During the examination of Arlington Mutual Fire Insurance Company, it was determined that the company has partially complied with two prior exam recommendations and that it has not complied with three recommendations already repeated on prior examinations. The company needs to focus greater attention on these and other recommendations of the current examination listed in a summary form on the following page. There were no reclassifications or adjustments to surplus.

Arlington Mutual Fire Insurance Company reported admitted assets of $4,331,349, liabilities of $1,123,002 and surplus of $3,208,347 at December 31, 2004. The company has generated positive net income in the six-year period under examination, except in 2004 and in 2001. With the exception of 2004, 2002 and 2001, the company has maintained its net loss and loss adjustment expense ratio below the Wisconsin town mutual industry average. For all years under examination, the company reported underwriting expenses below the industry average.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 15 - Reinsurance—It is again recommended that the company properly disclose its net exposure to its largest risk in the General Interrogatories of future annual statements.

2. Page 16 - Underwriting—It is again recommended that the company establish and follow a formal inspection procedure for new and renewal business, and it is suggested that the photographs of insured risks be included as part of the procedure.

3. Page 17 - Accounts and Records—It is recommended that the company properly segregate the duties of signing checks and handling cash from those of performing the accounting functions and reconciling month-end bank balances in accordance with s. Ins 13.05 (4), Wis. Adm. Code.

4. Page 23 - Reinsurance Recoverable on Paid Losses and LAE—It is recommended that the company establish proper controls to ensure that the loss bordereau reports are filed correctly and timely with the reinsurer.

5. Page 25 - Net Unpaid Loses—It is recommended that the company maintain a loss register which supports its transactions and account balances and that the information of the claim files be periodically reconciled with the loss register.

6. Page 25 - Net Unpaid Loses—It is recommended for the third time that the company adopt procedures for timely settlement of claims in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

7. Page 25 - Net Unpaid Loses—It is recommended for the third time that the agents of the company provide information on all claim activity reported, adjusted and settled on a weekly basis. In addition, it is suggested that the company develop a form containing all the information required by s. Ins 13.05 (3) (f), Wis. Adm. Code, so that agents report claims in a uniform and timely manner to the company. This information then should be periodically reconciled with the loss register.

8. Page 26 - Commissions Payable—It is recommended that the premium and loss information utilized to calculate the contingent commissions due to agents agree with the property premium and loss information reported on the annual statement.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, John Litweiler of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Carina Toselli
Examiner-in-Charge